

Message Text

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PAGE 01 OECD P 02195 01 OF 03 252153Z

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ACTION EUR-25

INFO OCT-01 ISO-00 AID-20 CEA-02 CIAE-00 COME-00 EB-11

EA-11 FRB-02 INR-10 IO-14 NEA-11 NSAE-00 RSC-01

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H-03 DODE-00 PA-04 USIA-15 PRS-01 DRC-01 /235 W

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FM USMISSION OECD PARIS

TO SECSTATE WASHDC 1660

C O N F I D E N T I A L SECTION 1 OF 3 OECD PARIS 2195

STATE ALSO FOR T/IEP

FOR DONALDSON AND SIMON FROM CHARGE

E.O. 11652: GDS

TAGS:ENRG, OECD

SUBJECT: ENERGY CONFERENCE: ALTERNATIVE PROPOSAL TO REPLACE
OPEC MEASURES

REF: STATE 009353

1. SUMMARY. SINCE OIL PRODUCING COUNTRIES' MEASURES
WOULD IMPOSE STAGGERING BURDEN WHICH WOULD EXCEED ECONOMIC AD-
JUSTMENT CAPABILITIES OF WORLD ECONOMY, WE SHOULD RESPOND
WITH ALTERNATIVE PROPOSALS FOR CONSTRUCTIVE NATURE, THIS
MESSAGE DEVELOPS BASIS AND OUTLINE OF POSSIBLE ALTERNATIVE
PLAN FOR OIL PRICE/PRODUCTION. END SUMMARY.

I. INTRODUCTION

2. MEASURES TAKEN BY THE OIL PRODUCING COUNTRIES CONSTITUTE
ECONOMIC ACTIONS WHICH HAVE ENORMOUS ECONOMIC EFFECTS ON
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PAGE 02 OECD P 02195 01 OF 03 252153Z

REST OF WORLD. EVEN IF ADOPTED PARTLY FOR POLITICAL/

MILITARY OBJECTIVES, THESE MEASURES NEED TO BE CONSIDERED IN AN ANALYTICAL AND NEGOTIATING FRAMEWORK SUFFICIENTLY COMPLETE, SO AS (1) TO ASCERTAIN THEIR IMPACT, IF CARRIED OUT, ON WORLD ECONOMIC RELATIONS, (2) TO JUDGE THE SUITABILITY ECONOMICALLY OF THESE ACTIONS, AS WELL AS THEIR CONFORMITY WITH ACCEPTED RULES OF INTERNATIONAL BEHAVIOR, AND (3) TO CONSIDER WHETHER THERE ARE OTHER APPROACHES CONCEIVABLE, OTHER THAN THOSE IMPLIED IN OPEC MEASURES, FOR ACCOMPLISHING LEGITIMATE OBJECTIVES WITHOUT INCURRING THE SAME DEGREE OF DAMAGE TO THE REST OF THE DEVELOPED AND LESS-DEVELOPED WORLD. POINTS (2) AND (3) HAVE NOT RECEIVED ADEQUATE CONSIDERATION, ATTENTION HAVING BEEN LARGELY CONCENTRATED EITHER UPON WHAT STEPS THE CONSUMING COUNTRIES COULD TAKE (CONSERVATION, ALTERNATIVE SOURCES, ETC.) TO ACCOMMODATE THEMSELVES TO THE PRODUCERS' ACTIONS OR UPON WHETHER THE PRODUCING NATIONS WOULD UNILATERALLY ABANDON THEIR ACTIONS VOLUNTARILY OR BY INTERNAL DISSENSION.

II. SUITABILITY OF GLOBAL ECONOMIC EFFECTS.

3. THE RESULTS FOR THE WORLD OF THE ECONOMIC MEASURES IMPOSED BY THE OIL-PRODUCING COUNTRIES WHICH ARE FORESEEN, BY NATIONAL GOVERNMENTS AND INTERGOVERNMENTAL ECONOMIC BODIES, CAN BE RECAPITULATED BRIEFLY AS FOLLOWS. THE PRICES WHICH HAVE BEEN RECENTLY SET FOR CRUDE PETROLEUM WOULD RAISE THE GENERAL PRICE LEVEL OF THE INDUSTRIALIZED COUNTRIES BY 2-3 PERCENTAGE POINTS, WHICH WOULD RAISE THE RATE OF INFLATION ABOUT 2-30 PER CENT ABOVE THE PRESENT ALREADY-HIGH RATE OF PRICE RISE. ANY FURTHER ELEVATION OF CRUDE OIL PRICES WOULD AGGRAVATE WORLD PRICE TRENDS STILL FURTHER. IN THE LESS-DEVELOPED COUNTRIES, THE PRICE EFFECTS WOULD VARY CONSIDERABLY, DEPENDING ON THE COUNTRY CONCERNED, BUT WOULD BE SUBSTANTIAL. THE BALANCE OF PAYMENTS IMPACT WOULD BE STRIKING. OIL-PRODUCING COUNTRIES AS A GROUP WOULD EXPERIENCE A NET INCREASE IN THEIR BALANCE OF PAYMENTS ON CURRENT ACCOUNT OF ABOUT \$50 BILLION PER ANNUM (ASSUMING PRESENT RATES OF OIL EXPORTATION), ABOUT \$8-10 BILLION OF THIS BEING REFLECTED IN AN INCREASED DEFICIT OF THE NON-OIL LDC'S AND \$40-42 BILLION COMING FROM A SHIFT IN THE CURRENT-ACCOUNT POSITION OF THE DEVELOPED COUNTRIES. OIL-IMPORTING COUNTRIES WOULD SUFFER A CONTRACTION IN EMPLOYMENT

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PAGE 03 OECD P 02195 01 OF 03 252153Z

AND GENERAL ACTIVITY, THE AMOUNTS VARYING ACCORDING TO THEIR STRUCTURES AND THEIR ABILITY FOR CONSERVATION STEPS NOT AFFECTING PRODUCTIVE OUTPUT. (OECD DOCUMENTS PRESENT A MORE DETAILED ECONOMIC ASSESSMENT.)

4. AS A RESULT OF THE SHIFTS IN BALANCES OF PAYMENTS DESCRIBED ABOVE, THE MONETARY RESERVES AND OTHER FINANCIAL ASSETS OF THE OIL-PRODUCING COUNTRIES COULD BE EXPECTED TO RISE AT THE

RATE OF ABOUT \$55 BILLION ANNUALLY, IF THE ASSUMPTIONS ABOUT THEIR IMPORT-ELASTICITIES, ETC., EMBODIED IN THE BALANCE OF PAYMENTS ESTIMATES HAVE BEEN ACCURATE. SUCH A RATE OF ACCUMULATION, IF RECORDED BY A COUNTRY OR GROUP IN THE INDUSTRIALIZED WORLD, WOULD BE REGARDED AS COMPLETELY UNACCEPTABLE AND WOULD BE TAKEN AS EVIDENCE OF FUNDAMENTAL DISEQUILIBRIUM, EITHER UNDER THE EXISTING BRETTON WOODS STANDARDS OR UNDER THOSE "RELATIVELY STABLE BUT ADJUSTABLE" RATE STANDARDS BEING CONSIDERED FOR THE REFORMED MONETARY SYSTEM.

5. SINCE THE COUNTRIES WHOSE RESERVES WOULD BE RISING SO DRAMATICALLY ARE NOT, OF COURSE, INDUSTRIALIZED NATIONS, ONE MUST PERHAPS PAUSE TO ASK WHETHER THERE ARE SPECIAL CIRCUMSTANCES REQUIRING A DIFFERENT SET OF RULES. IF THE ENORMOUS RISE IN THEIR FOREIGN EXCHANGE RECEIPTS WERE TO BE UTILIZED, IMMEDIATELY OR WITH SLIGHT DELAY, TO PAY FOR A ROUGHLY-CORRESPONDING INCREMENT OF IMPORTS, THE INTERNATIONAL ADJUSTMENT PROCESS WOULD WORK ITSELF OUT THROUGH A HIGHER LEVEL OF WORLD TRADE. THAT IS NOT THE CASE IN THIS SITUATION, EVEN IF THE ASSUMPTIONS ABOUT CONSUMPTION UNDERLYING THE RESERVE FIGURES ARE NOT COMPLETELY ACCURATE. IF THE GREATER PART OF THE BULGE IN EXPORT RECEIPTS WOULD NOT BE SPENT ON IMPORTS, THE RESERVE ACCUMULATION WOULD EITHER BE SOMEHOW IMPOUNDED (WHICH IS DIFFICULT TO ACCOMPLISH IN THE MODERN WORLD), WITH CORRESPONDING GENERAL DEFLATIONARY EFFECTS; OR WOULD ENTER INTO THE CAPITAL AND COMMODITY MARKETS TO BID UP THE PRICES OF ASSETS AND STIMULATE INFLATION FURTHER. (THIS LATTER INFLUENCE COULD BE MITIGATED TO THE LIMITED DEGREE THAT OPEC NATIONS MAY MAKE DIRECT INVESTMENTS ABROAD.) THESE EFFECTS WOULD OCCUR, BY AND LARGE, REGARDLESS OF WHICH NATIONAL CURRENCIES WERE USED FOR PAYMENT.

6. TO ALLOW THIS WORLD PAYMENTS SHIFT TO HAPPEN WOULD,
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PAGE 04 OECD P 02195 01 OF 03 252153Z

LOOKED AT IN ANOTHER WAY, CREATE A SITUATION ANALOGOUS TO CARRYING OUT A REALIGNMENT OF WORLD CURRENCIES--BUT A REALIGNMENT OF A MOST FRUSTRATED SORT. I.E., THE COUNTRIES WHICH WOULD HAVE REVALUED (THE OPEC NATIONS) WOULD NOT HAVE THE DOMESTIC INCOME AND CONSUMPTION-ELASTICITIES TO EXPAND THEIR IMPORTS, AND THE DEVALUING (INDUSTRIAL) COUNTRIES WOULD CORRESPONDINGLY NOT BE ABLE TO RESTORE BALANCE BY EXPANDING THEIR EXPORTS. IT IS, THEREFORE, HARD TO AVOID THE CONCLUSION THAT IT WOULD BE BETTER FOR THE WORLD TO PREVENT THE OCCURRENCE OF THIS HUGE PAYMENTS AND RESERVE SHIFT, RATHER THAN TO CONCENTRATE ON WAYS IN WHICH TO FINANCE IT, AS IS BEING DONE IN SOME QUARTERS.

7. WHAT ARE THE TECHNIQUES BY WHICH THE OIL PRODUCERS' POLICIES IMPOSE ON THE WORLD THE PROSPECT OF ACCELERATED

INFLATION, UNEMPLOYMENT, AND DISRUPTION OF THE BALANCE OF
PAYMENTS? APART FROM THE USE OF SUDDEN AND SUBSTANTIAL
PRICE INCREASES FOR CRUDE OIL, THE TECHNIQUES ARE QUANTITATI
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PAGE 01 OECD P 02195 02 OF 03 251209Z

46
ACTION EUR-25

INFO OCT-01 ISO-00 AID-20 CEA-02 CIAE-00 COME-00 EB-11

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C O N F I D E N T I A L SECTION 2 OF 3 OECD PARIS 2195

TO CONTROL TEMPORARILY THE VOLUME OF EXPORTS OF SOYBEANS,
FOR DOMESTIC ANTI-INFLATIONARY REASONS, THIS LIMITED MEASURE WAS
INSTANTLY GREETED WITH FIRM, OFFICIAL PROTESTS BY OTHER GOVERN-
MENTS. THOSE NATIONS CALLED FOR SYSTEMATIC EXAMINATION OF THE
U.S. MEASURES IN VARIOUS INTERGOVERNMENTAL BODIES, AND SPECIAL
BILATERAL DISCUSSIONS WITH THE U.S. WERE REQUESTED BY THE
EUROPEAN COMMUNITY, JAPAN, AND OTHERS. WHATEVER MAY HAVE BEEN
THE NECESSITY OR WISDOM OF THE U.S. PRECAUTIONARY MEASURES ON
SOYBEANS, THEY WERE SUBJECTED TO THE FULL WEIGHT OF INTERNATIONAL
SCRUTINY AND, PARTLY FOR THAT REASON, WERE MILDLY APPLIED
AND WERE REMOVED WITHIN 12 WEEKS.

9. IN THE CASE OF THE PETROLEUM MEASURES, NEITHER THE
UNITED STATES NOR ANY OTHER NATION HAS RESORTED TO FORMAL
CITATION OF THE STEPS AS BEING CONTRARY TO ESTABLISHED
PRINCIPLES OF ECONOMIC COOPERATION OR GOOD TRADE PRACTICE.
IT IS TRUE THAT ONLY A FEW OIL-PRODUCING COUNTRIES ARE MEMBERS
OF THE GATT, WHICH RULES OUT THAT FORUM FOR THIS PURPOSE.
HOWEVER, THEY ALL ARE MEMBERS OF THE IMF, IBRD, AND UN.
THE CHARTERS OF THOSE ORGANIZATIONS IMPOSE OBLIGATIONS FOR
ECONOMIC COOPERATION AND FOR REFRAINING FROM ACTION HARMFUL
TO OTHER MEMBERS. THE INCONSISTENCY OF PRESENT OAPEC OIL
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PAGE 02 OECD P 02195 02 OF 03 251209Z

MEASURES WITH INTERNATIONAL UNDERTAKINGS AND STANDARDS SHOULD BE POINTED OUT. IN ORDER TO PUT THESE ACTIONS IN THEIR PROPER LIGHT AND IN ORDER, IF COUNTER-PROPOSAL DESCRIBED IN THE SECTION BELOW SHOULD BE ADOPTED, TO PROVIDE A SUPPORTING FRAMEWORK OF ARGUMENT. WHILE THE CITING OF THE INFRACTIONS OF THE RULES AND SPIRIT OF INTERNATIONAL BEHAVIOR SHOULD BE EXPRESSED OBJECTIVELY, IT SHOULD BE DONE CLEARLY AND WITHOUT DELAY, EITHER BY THE UNITED STATES ALONE OR IN CONCERT WITH OTHER COUNTRIES. THIS STEP SHOULD BE PHASED IN COORDINATION WITH THE PROPOSAL DESCRIBED BELOW.

III. ALTERNATIVE PROPOSAL ON OPEC OIL PRODUCTION AND PRICE

10. IF THE MEASURES TAKEN BY THE OIL PRODUCING COUNTRIES WOULD HAVE ECONOMIC EFFECTS ON THE REST OF THE WORLD WHICH ARE NOT MERELY INAPPROPRIATE BUT HIGHLY DAMAGING, AND IF THESE MEASURES STAND IN CONFLICT WITH GENERALLY-ACCEPTED OBLIGATIONS REGARDING INTERNATIONAL CONDUCT, WHAT RESPONSES ARE OPEN AND ADVISABLE FOR THE INTERNATIONAL COMMUNITY OTHER THAN PASSIVE ACCOMMODATION? THE ALTERNATIVES TO MERE ACCOMMODATION SEEM TO LIE EITHER IN COUNTER-MEASURES OR IN SOME CONSTRUCTIVE NEW PLAN. NEITHER HAS TO BE COMPLETELY DISCARDED FOR THE MOMENT. COUNTER-MEASURES OR SANCTIONS HAVE THEIR PLACE IN FOREIGN RELATIONS. IN THE PRESENT INSTANCE, ECONOMIC AND POLITICAL SANCTIONS (MILITARY ONES ARE EXCLUDED FROM THIS PAPER ON PRINCIPLE AS WELL AS EXPEDIENCY) WOULD NOT BE VERY QUICK-ACTING IN THE SHORT RUN EVEN IF TAKEN COLLECTIVELY BY THE WEST, AND THEIR NEGATIVE CHARACTER CLOTHES THEM WITH LITTLE PUBLIC APPEAL.

11. WHAT SEEMS TO BE REQUIRED, THEREFORE, IS A CONSTRUCTIVE PLAN THAT COULD BE RECOMMENDED TO PRODUCING AND CONSUMING NATIONS ALIKE AS OFFERING BETTER PROSPECTS OF ACCOMPLISHING LEGITIMATE OBJECTIVES FOR THE OPEC COUNTRIES IN THE NEXT FEW YEARS WITHOUT INCURRING UNDUE DAMAGE TO THE REST OF THE WORLD. THE FUNDAMENTAL ERRORS INVOLVED IN OPEC'S PRESENT APPROACH ARE THAT ITS COMBINATION OF MEASURES WOULD PRODUCE A SHIFT OF PRICES, PRODUCTION, PAYMENTS POSITIONS, AND MONETARY RESERVES THAT IS QUITE PROBABLY LARGER THAN NECESSARY OR ECONOMICALLY ACCEPTABLE AND THAT IS CERTAINLY MORE RAPID THAN THE WORLD ECONOMIC SYSTEM HAS THE CAPABILITY TO ADJUST TO OR ABSORB.

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PAGE 03 OECD P 02195 02 OF 03 251209Z

THE RESULTS--APART FROM THE STAGGERING EFFECTS UPON THE NON-OIL LDC'S AND THE MAJOR TRADING NATIONS--WOULD BE THAT THE OPEC COUNTRIES THEMSELVES WOULD ACQUIRE A VOLUME OF RESERVE ASSETS WHICH THEIR ECONOMIES COULD NOT EFFECTIVELY EMPLOY AND WHICH WOULD BRING NO SOCIAL BENEFIT TO THEIR POPULATIONS IN THE SHORT RUN. THE MAGNITUDE OF THE ECONOMIC DISLOCATIONS MIGHT WELL, IN

THE LONGER RUN, INDUCE OTHER COUNTRIES TO CARRY OUT SHIFTS
IN THEIR CONSUMPTION AND TRADING PATTERNS THAT WOULD NOT
BENEFIT THE POEC COUNTRIES.

12. WHEN WE TRY TO DEFINE THE "LEGITIMATE ASPIRATIONS" OF
PARTICIPANTS IN THE PETROLEUM MARKETS, THE CRITERIA PROBABLY
HAVE TO MAKE PROVISION BOTH FOR LEVELS OF PRODUCTION AND
PRICES AND FOR RATES OF CHANGE. OIL-PRODUCING COUNTRIES
JUSTIFIABLY NEED A COMBINATION OF PRICE AND OUTPUT WHICH
EMBODY A SATISFACTORILY GRADUAL PACE OF OIL DEPLETION AND WHICH
WILL YIELD REVENUES COVERING A SUFFICIENT PORTION OF THEIR
PRESENT BALANCE OF PAYMENTS NEEDS; WHICH WILL GROW COMMENSURATE
WITH RISING CONSUMPTION AND INVESTMENT AS THEIR ECONOMIC
DEVELOPMENT OCCURS; AND WHICH WILL BE CAPABLE OF ADAPTATION
AS TECHNOLOGY AND WORLD DEMANDS FOR DIFFERENT FUELS EVOLVE.
THE LDC'S NOT PRESENTLY PRODUCING OIL, CORRESPONDINGLY, NEED
A REASONABLY STABLE EVOLUTION IN THE PRICE AND AVAILABILITY
OF IMPORTED PETROLEUM SO THAT THEIR DEVELOPMENT PLANS CAN BE
CARRIED ON WITHOUT UNMANAGEABLY SUDDEN SHIFTS. THE OBJECTIVE
NEEDS OF THE DEVELOPED CONSUMING COUNTRIES CAN BE SUMMARIZED
IN CORRESPONDING FASHION.

13. CUTTING THROUGH THESE GENERALIZATIONS, THE ESSENTIAL
ATTRIBUTES OF A VIABLE ALTERNATIVE PLAN SEEM ALONG THE
FOLLOWING LINES. AGREEMENT SHOULD BE SOUGHT FOR ESTABLISHING
OIL PRODUCTION AND EXPORT RATES FOR 1974 ROUGHLY EQUALING OR
EXCEEDING THE SEPTEMBER 1973 RATES AND ADOPTING NEW F.O.B.
PRICES SET SUBSTANTIALLY BELOW THOSE ANNOUNCED DECEMBER 28.
FOR FUTURE YEARS, AN INTERNATIONAL FRAMEWORK FOR CONSULTATION
SHOULD BE OFFERED, PROVIDING IN SOME FASHION FOR PARTICIPATION
FROM SELECTED PRODUCING AND CONSUMING COUNTRIES AND FROM THE
WORLD BANK, IMF, AND OECD. THE FACTUAL ELEMENTS FORMING
THE BASIS FOR CONSULTATION WOULD INCLUDE THE OPEC COUNTRIES'
ECONOMIC DEVELOPMENT PROGRAMS; ANY PRESENT SCHEDULES THEY
MAY HAVE ON EXTRACTION RATES AT WHICH THEY WOULD AIM;
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PAGE 04 OECD P 02195 02 OF 03 251209Z

INDEXES ON PRICES OF MANUFACTURED GOODS AND FOODSTUFFS;
INFORMATION

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PAGE 01 OECD P 02195 03 OF 03 251242Z

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ACTION EUR-25

INFO OCT-01 ISO-00 AID-20 CEA-02 CIAE-00 COME-00 EB-11

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C O N F I D E N T I A L SECTION 3 OF 3 OECD PARIS 2195

FROM THE CONSUMING COUNTRY GOVERNMENTS AND OIL COMPANIES
ABOUT PLANNED PETROLEUM INVESTMENT, GENERAL ECONOMIC OUTLOOK,
ETC.

14. ANNUAL OR MORE FREQUENT PERIODIC CONSULTATION WOULD

SEEK TO ESTABLISH AN AGREED GENERAL RANGE OF OUPUT THAT
WOULD BE SUITABLE FOR THE COMING YEAR FOR THE WORLD AS
A WHOLE AND FOR BROAD REGIONS. FIRST, WITHIN THE BROAD
ECONOMIC OUTLOOK THUS ESTABLISHED BY INTERGOVERNMENTAL
CONSULTATION FOR 1975 (AND ANNUALLY THEREAFTER), AN ATTEMPT
WOULD BE MADE TO REACH CONSENSUS ON THE PRICE SCHEDULE
APPLICABLE FOR THAT MARKETING PERIOD. ONCE THE PRICE
SCHEDULE WAS ESTABLISHED, INDIVIDUAL EXPORT TRANSACTIONS
WOULD HAVE TO PROCEED GENERALLY IN ACCORD WITH IT, BUT
DEVIATIONS FROM IT OF NO MORE THAN , SAY, 50 CENTS PER
BARREL UP OR DOWN WOULD BE PERMITTED. SECONDLY, WITHIN THE
BROAD FRAMEWORK INDIVIDUALY SELLING COUNTRIES COULD INDICATE THE
QUANTITIES THEY ARE PREPARED TO HAVE LIFTED AND BUYERS
WOULD BE FREE TO ENTER CONTRACTS ON THE
VOLUME OF OIL TO BE EXTRACTED AND EXPORTED DURING THE GIVEN
PERIOD, PROVIDED THEY REPORTED THE AGREED VOLUMES TO THE
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PAGE 02 OECD P 02195 03 OF 03 251242Z

CENTRAL INTERGOVERNMENTAL BODY. THE PURPOSE OF THIS LATTER
PROVISION WOULD BE TO COMPARE THE RESULTING AGGREGATE CONTRACT
FIGURES FOR THE WHOLE INDUSTRY WITH THE PROJECTED AGGREGATE
SUPPLY/DEMAND PROJECTIONS. IF THESE AGGREGATES DIFFERED BY
MORE THAN A SMALL, PREVIOUSLY-FIXED PERCENTAGE, NEW GOVERNMENTAL
CONSULTATIONS COULD BE CALLED INTO PLAY. THE TALKS WOULD
PERMIT, FOR EXAMPLE, A REDUCTION IN CONTRACTED EXPORTS OF SAUDI

ARABIAN OIL TO BE COMPENSATED BY INCREASING THE PLANNED EXPORTS FROM OTHER SOURCES. THIRDLY, IN EACH NEW YEAR'S CONSULTATION EXERCISE, THE PRESUMPTION SHOULD UNDERLIE THE CONSULTATIONS THAT THE PRICE SCHEDULE FOR THE MARKETING PERIOD SHOULD NORMALLY NOT DIFFER FROM THE PRECEDING PERIOD BY MORE THAN A LIMITED MARGIN. THIS WOULD GIVE A PRESUMPTIVE FLOOR AND CEILING TO THE DISCUSSIONS AND ASSURE SOME STABILITY TO MARKET EXPECTATIONS.

15 PRESENTATION OF SUCH AN APPROACH TO THE OIL PRICE AND SUPPLY PROBLEM SHOULD NOT BE TAKEN AS ADVOCATING DETAILED GOVERNMENTAL PLANNING AND CONTROLS. RATHER, THE OBJECT SHOULD BE UNDERSTOOD TO BE TO PROVIDE AN ACCEPTED PROCEDURAL FRAMEWORK FOR DEVELOPING ROUGH OVERALL PROJECTIONS AND FOR ADOPTING A FEW RULES WITHIN WHICH INDIVIDUAL CONTRACTS WOULD BE REACHED BY DIRECT BARGAINING. FINALLY, NO IMPLICATION SHOULD BE GIVEN THAT EVEN THIS DEGREE OF INTER-GOVERNMENTAL SURVEILLANCE WOULD NECESSARILY BE WARRANTED FOR OTHER BASIC COMMODITIES, AND ESPECIALLY NOT UNLESS THEY COULD MATCH THE VERY SPECIAL CHARACTERISTICS OF PETROLEUM. PROPOSALS ON THESE LINES SHOULD BE FITTED INTO OVERALL POLICY THAT WOULD ALSO TAKE ACCOUNT AID REQUIREMENTS OF NON-OIL LDC'S, AS INDICATED BY SEC. SHULTZ AT ROME.

16. DEPARTMENT REPEAT IF DESIRED.
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